DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 03-0078
Corporate Income Tax
For the Periods 1999 and 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Pre-Merger Special Corporation Status.

Authority: IC 6-2.1-3-24; IC 6-2.1-3-24.5; IC 6-3-2-2.8(2); 45 IAC 1.1-3-11; I.R.C. § 1361(b); I.R.C. § 1361(b)-(d); I.R.C. § 1361(b)(3); I.R.C. § 1361(b)(3)(A); I.R.C. § 1361(b)(3)(B)(ii); I.R.C. § 1363.

Taxpayer, as a subsidiary of parent corporation qualified to file as an S-Corporation prior to its merger in May of 1999, argues that it was itself entitled to file tax returns as a SC (Special Corporation) return.

II. Post-Merger Special Corporation Status.

Authority: IC 6-2.1-3-24.5; 45 IAC 1.1-3-11; I.R.C. § 1361(b).

Taxpayer maintains that, having merged with its parent company in May of 1999, it was thereafter entitled to file tax returns as an S-Corporation.

III. Equitable Estoppel – Special Corporation Status.

Authority: Hi-Way Dispatch, Inc. v. Indiana Dept. of State Revenue, 756 N.E.2d 587 (Ind. Tax Ct. 2001); 45 IAC 15-3-2(d)(3); 45 IAC 15-3-2(e); Black's Law Dictionary (7th ed. 1999).

Taxpayer maintains that the Department of Revenue is equitably estopped from disallowing its pre-merger claim to Special Corporation status.

STATEMENT OF FACTS

Taxpayer performed several construction contracts within the state. Taxpayer filed an Indiana income tax return as an SC-Corporation. During an audit of taxpayer business records and tax returns, the Department of Revenue (Department) determined taxpayer did not qualify for SC-Corporation status and assessed corporate income taxes accordingly. The taxpayer disagreed with the Department's interpretation and application of the law and submitted a protest to that effect. An administrative hearing was conducted, and this Letter of Findings results.

DISCUSSION

I. Pre-Merger Special Corporation Status.

Taxpayer merged with its parent company May 1, 1999. Previous to that date, taxpayer operated as a subsidiary of the parent company completing construction projects within the state. Taxpayer maintains that because – prior to the merger – the parent company could have made an S-Corporation election, taxpayer itself could also have made an S-Corporation election. There is no dispute that during the pre-merger period, neither parent company nor taxpayer had made an S-Corporation election. Nonetheless, taxpayer maintains that because it *could* have made the election, it was entitled to submit an SC-Return.

IC 6-2.1-3-24 states that "Gross income received by a corporation that is exempt from the adjusted gross income tax under IC 6-3-2-2.8(2) is exempt from gross income tax." In turn, IC 6-3-2-2.8(2) provides an exemption for the state's adjusted gross income tax to "Any corporation which is exempt from income tax under Section 1363 of the Internal Revenue Code . . . ." I.R.C. § 1363 sets out the tax treatment afforded S-Corporations and its shareholders.

Taxpayer maintains that it was qualified to file as an S-Corporation during the pre-merger period. According to taxpayer, it was a domestic corporation, it had no more than 75 shareholders, the shareholders were all individuals or "qualified shareholders," and taxpayer had only one class of stock. *See* I.R.C. § 1361(b)-(d).

In effect, taxpayer argues that it is a qualified subchapter S subsidiary (QSSS). A QSSS is a wholly-owned subsidiary of a parent S-Corporation that the parent corporation decides to treat as a QSSS. *See* I.R.C. § 1361(b)(3). For federal and state purposes, a QSSS is not treated as a separate entity, and all of its assets, liabilities, and tax items are treated as the assets liabilities, and tax items of the parent S-Corporation. I.R.C. § 1361(b)(3)(A). Therefore, for federal and state tax purposes, the QSSS is disregarded as an entity separate from the parent S-Corporation, and all of the QSSS's tax information is reported on the parent S-Corporation's informational tax returns.

In addition, Indiana exempts from adjusted gross income tax the income of a "Special Corporation." Under IC 6-2.1-3-24.5 and 45 IAC 1.1-3-11, a "Special Corporation" is a corporation which otherwise qualifies as an S-Corporation as defined in I.R.C. § 1361(b) but which has *not* made the required federal election. Presumably, under IC 6-2.1-3-24.5, taxpayer's parent company could have qualified to submit an Indiana tax return as a "Special Corporation."

However, the issue is not whether the parent company could have qualified to file as a Special Corporation. Taxpayer argues that as a putative QSSS, it also could have filed – without making a federal election – as a "Special Corporation." Taxpayer maintains that it met the qualifications set out in I.R.C. § 1361(b) and "[a]s a result [taxpayer] could have made a valid S election and therefore would have qualified as a special corporation for Indiana tax purposes for the [pre-merger] period."

The Department is unable to agree with taxpayer's conclusion. Under I.R.C. § 1361(b)(3), the tax treatment and the qualifications of a subsidiary owned by an S-Corporation, are not the same. In order for a putative QSSS to qualify for S-Corporation status, I.R.C. § 1361(b)(3)(B)(ii) requires the parent company to make a second federal election to treat the subsidiary as a QSSS.

Under the IRC provision, only a parent-corporation which has itself made an election to file as a S-Corporation may make the second federal election to treat the subsidiary as a QSSS. Taxpayer urges the Department not to read the federal regulations so narrowly as to deny taxpayer's request for relief based upon the parent company's failure to make such an election. According to taxpayer, because the parent company *could* have made the election, it was not necessary to actually do so. The Department declines taxpayer's invitation to so interpret the Indiana and federal codes and ignore the explicit election requirement specified in I.R.C. § 1361(b)(3)(B)(ii).

FINDING

Taxpayer's protest is respectfully denied.

II. Post-Merger Special Corporation Status.

The Department's audit of taxpayer's business records and tax returns covered the periods ending April 30, 1999, and April 30, 2000. According to taxpayer, it completed a merger with the parent company on May 1, 1999. As a result, "there no longer was a parent corporation and a subsidiary C corporation situation."

Taxpayer has submitted documentation substantiating its merger with the parent company and that the merger was effective on April 30, 1999. Taxpayer has also submitted information documenting that it submitted a federal Form 2553 by which the combined corporation (taxpayer) elected to be treated as an S-Corporation. In addition, taxpayer supplied a copy of an acknowledgement by the Internal Revenue Service accepting taxpayer's "election to be treated as an S corporation with an accounting period of Jan. 31, 2001, beginning May 01, 2000."

Taxpayer argues that it was entitled to S-Corporation status after May 1, 1999 because the parent / subsidiary relationship ended and the combined entity qualified as an S-Corporation. Taxpayer's argument is based on IC 6-2.1-3-24.5 and 45 IAC 1.1-3-11, defining "Special Corporation. A "Special Corporation" is a corporation which otherwise qualifies as an S-Corporation as defined in I.R.C. § 1361(b) but which has not made the federal election. The Department agrees that – based upon the information supplied – the combined entity would have qualified as a Special Corporation under IC 6-2.1-3-24.5 as of the day the two predecessor entities merged.

FINDING

Subject to a determination by the supplemental audit, taxpayer's protest is sustained.

III. Equitable Estoppel – S-Corporation Status.

Taxpayer argues that the Department is estopped from denying its claim to S-Corporation status during the pre-merger period. According to taxpayer, taxpayer's representative sought the Department's opinion regarding its QSSS status. Taxpayer states that a representative of the Department confirmed its own conclusion that taxpayer – as a subsidiary of a qualifying parent – was a "special corporation" because the only requirement was that taxpayer "could have made the election."

Equitable estoppel is a defensive doctrine which "prevents one party from taking unfair advantage of another when, through false language or conduct, the person to be estopped has induced another person to act in a certain way . . . ." Black's Law Dictionary 571 (7th ed. 1999). Taxpayer maintains that, after having relied upon statements of a competent Department representative, the Department may not afterwards back-track on its position to the taxpayer's detriment.

"Equitable estoppel cannot ordinarily be applied against government entities." Hi-Way Dispatch, Inc. v. Indiana Dept. of State Revenue, 756 N.E.2d 587, 598 (Ind. Tax Ct. 2001). However, application of the doctrine against a government entity is not absolutely prohibited. Id. The exception to this general rule is where "the public interest would be threatened by the government's conduct." Id.

Even accepting taxpayer's assertion, that it relied on incorrect guidance from the Department to its detriment, the Department does not conclude that the incorrect advice threatened the public's interest.

A taxpayer does have the right to rely upon the written opinions offered by the Department in response to specific requests made by a taxpayer. "In respect to rulings issued by the department, based on a particular situation which may affect the tax liability of the taxpayer, only the taxpayer to whom the ruling was issued is entitled to rely on it." 45 IAC 15-3-2(d)(3). However, the rules specifically state that "Oral opinions or advice will not be binding upon the department." 45 IAC 15-3-2(e). Where written questions inquire as to the tax consequences of a particular transactions, "[T]he department may consider such letters as rulings that may bind the department to the position stated in respect to that taxpayer only." Id.

Taxpayer sought advice from a Department representative. At this point, it is not possible to fully understand the particular question taxpayer tendered to the representative; it is not possible to know if the representative fully and correctly understood the taxpayer's question or taxpayer's particular business circumstances; it is not possible to know precisely how the representative responded to the taxpayer's questions. The advice offered was not provided in the form of a written ruling which would thereafter bind the Department. There is no indication that the oral advice offered to the taxpayer – correct or incorrect – threatened the larger public interest.

FINDING

Taxpayer's protest is respectfully denied.

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